

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interviews of Christine Ruess on May 10, 2006, May 15, 2006, and June 20, 2006

DATED: June 1, 2006 (May 10, 2006 / May 15, 2006); June 20, 2006 (June 20, 2006)

On May 10, 2006, Sharon Blaskey and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Christine Ruess, from the City of San Diego Financing Services Department, at the City Administration Building, 202 C Street in San Diego, in a conference room on the third floor. Ms. Ruess was represented by Rod Greek, Proprietary Section Manager in the Office of the City Auditor and Comptroller for the City of San Diego.

Ms. Ruess contacted Mr. Shapiro on May 15, 2006 and asked to speak further about her interview. Ms. Ruess was contacted by phone on May 15, 2006 at 12:45 p.m. EST and interviewed further by Sharon Blaskey and Michael Shapiro.

On June 20, 2006, Mr. Shapiro interviewed Ms. Ruess by telephone. Johnny Giang and Tammie Davis from KPMG also participated in this interview. Ms. Ruess was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Christine Ruess, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Ms. Blaskey began the interview by explaining the circumstances and purpose of the City of San Diego's (the "City") creation of the Audit Committee, noting that information obtained during the course of the interview would be used, if relevant, in the Audit Committee's eventual report. Ms. Blaskey explained that Willkie does not represent Ms. Ruess and, thus, statements made during the interview are not covered by the attorney-client privilege. Nonetheless, we would be treating the information obtained during the interview as confidential, covered by the work-product privilege during the investigation, but any such privilege would likely be lost with the release of the Audit Committee's report. Ms. Blaskey asked that Ms. Ruess keep the interview confidential. Ms. Blaskey further explained that, if requested, we would provide information from the interview to the SEC, the U.S. Attorney's Office or the City's outside auditor, KPMG, so it is important that Ms. Ruess be accurate and truthful. Ms. Blaskey emphasized that Ms. Ruess should seek clarification of any question at any time.

Background

Ms. Blaskey asked Ms. Ruess about her professional background. Ms. Ruess said that after receiving a degree in Public Administration at San Diego State University, she started to work in San Diego in 1991 in the Water Department as a Revenue Analyst and stayed in that position until 1994. She left the City's employment for two years and then joined Financing Services in 1996 as a Management Analyst. She then was a Water Rate Analyst, a position in which she worked on water financings and water rates. Ms. Ruess currently serves as Utilities Finance Administrator, having replaced Dennis Kahlie when he left the City's employment in March 2006. In this position, she works on water and wastewater financing as well as water rates.

Ms. Blaskey asked Ms. Ruess to describe her reporting structure. She replied that she reported to Mr. Kahlie up until March 2006 and now reports to Lakshmi Kommi (Deputy Director, Financing Services). Ms. Blaskey asked Ms. Ruess whether, while in her former position as Water Rate Analyst, she interacted with the wastewater side of the utilities group. Ms. Ruess responded that she would "cross over" to help Eric Adachi (Rate Analyst, Supervising Economist, MWWD) sometimes or would work together with him on issues that concerned both departments like the Cost of Service Study ("COSS") for the water and wastewater departments.

Water State Revolving Fund Loans

Ms. Blaskey asked Ms. Ruess if she knew whether the State Revolving Fund ("SRF") loans for water related projects carry the same requirements as for wastewater related ones. Ms. Ruess said that there is no comparable requirement indicating what the water rates should be. The MWWD used a different rate structure than the Water Department.

Proposition 218

Ms. Blaskey asked Ms. Ruess to describe a COSS. She responded that a COSS classifies different expenditures and allocates them to different cost centers to make sure that no customer classification is subsidizing others and that the allocation is revenue neutral. Ms. Blaskey asked Ms. Ruess to discuss her recollections about the first COSS she participated in. Ms. Ruess said that shortly after she started working for Financing Services, the PinnacleOne Study was done (PinnacleOne was an outside consultant hired to perform a COSS in 1996-1997). The City was not happy with the work that was done because there was a feeling that PinnacleOne was not up to the task and not competent. She was only involved with the water side of the COSS and noted that Phil Moffitt (Financing Services), not Adachi, participated on the wastewater side since Mr. Adachi had not been hired yet. Ms. Ruess assumed that the compliance issues regarding SRF grants and loans spurred the launch of the Wastewater COSS, but she did not know for sure. She assumed that the Water COSS was done because it was a good practice to do them periodically, but noted that the State did not require a Water COSS be done.

Ms. Ruess was shown Exhibit 1, a May 14, 1998 Sewer Cost of Service Report. Ms. Blaskey asked Ms. Ruess when this COSS was completed. Ms. Ruess responded that she had no independent recollection of when the COSS was completed. Ms. Blaskey asked Ms. Ruess if she read this COSS at the time. She said she has not looked at the 1998 wastewater

COSS, or a more recent wastewater COSS from 2000 for a long time. Ms. Ruess "is sure" she read it in its entirety once. She volunteered that any COSS will suggest a change in rates. Ms. Blaskey asked Ms. Ruess if including COD was a significant or material change, and Ms. Ruess responded in the affirmative.

Ms. Blaskey asked Ms. Ruess to describe her involvement with the 2000 COSS. She responded that she was involved with the water COSS but "lots of information" was the same for both the water and wastewater COSS. She helped track down information that Black & Veatch requested and also did a large spreadsheet. She noted that the water and wastewater COSS are usually done on a parallel track but typically the water COSS is finished first because it is less complicated. Ms. Blaskey asked how long a COSS typically takes to be completed. Ms. Ruess responded that it generally took six months to do a COSS. She said the wastewater COSS took longer because the data had become stale and the City had to extend its contract for the COSS because of it.

Ms. Blaskey asked Ms. Ruess to discuss her knowledge of the 2003 COSS. She responded that the 2003 COSS had been initiated earlier was not initially completed, but that subsequently the COSS was completed. She said that the COSS included a COD component and said that adding COD was a function of the grant requirements to include BOD/COD.

Ms. Blaskey asked Ms. Ruess if she recalled whether the adoption of Proposition 218 ("Prop 218") spurred the COSS to be done. Ms. Ruess did not recall that happening. Ms. Blaskey asked Ms. Ruess whether Prop 218 had anything to do with the COSS. Ms. Ruess responded that Prop 218 might have had a small part to do with the COSS. She said that for as long as she could remember she did not think COD (chemical oxygen demand; organics) was required under Prop 218 but that COD/BOD (chemical oxygen demand/biological oxygen demand; organics) was required by the State for grants. She did not recall any discussion regarding Prop 218 and the COSS but noted that the COSS would not focus on Prop 218 since Prop 218 does not dictate how rates are set. She said that the *Bighorn* case concerning Prop 218 is currently being litigated and, even if the *Bighorn* Court decided that Prop 218 does not apply to water and wastewater, the City would still follow its noticing requirements.

City Compliance

Ms. Blaskey asked Ms. Ruess whether she was aware of the need to comply with State requirements from loan and grant conditions regarding wastewater rate setting. She responded that it has "always been out there" that the City had to comply and recalled seeing the State guidelines which called for compliance, but she had no knowledge about what the guidelines specifically required.

State Guidelines

Ms. Blaskey asked Ms. Ruess if she was familiar with the State guidelines. She responded that she knew guidelines existed but not what they said or if they impacted grants. Ms. Ruess noted that guidelines are not "the law" and are "not rules." Ms. Blaskey asked Ms. Ruess when she became aware that accounting for COD/BOD was a requirement. Ms. Ruess responded that she knew it was a requirement before the second Black & Veatch (outside

consultant hired to perform the COSS) COSS and probably learned of the requirement through discussions with Mr. Kahlie.

State Awareness of Noncompliance

Ms. Blaskey asked Ms. Ruess if the State was aware that the City's wastewater rate structure was not in compliance with state requirements. She responded that at some point, the State had knowledge that the rates did not meet its guidelines, but the State was not actively engaged in ensuring compliance. She said no one misrepresented to the State that the City met the guidelines. Later in the interview, she said that she did not know if the State was aware that the City was not meeting the guidelines. Ms. Blaskey asked Ms. Ruess if she recalled Mr. Kahlie telling her that Ronald Blair (Revenue Program Specialist for the State Water Resources Control Board) was confused about whether the City was in compliance. She did not recall Mr. Kahlie telling her so. She explained that sewer rates were not her main focus and if she had any involvement it would likely only have been because there was no one else around.

Compliance and Councilmember Kehoe

Ms. Ruess was shown Exhibit 2, an October 20, 1999 email from Dave Schlesinger to Myrna Zambrano re: "Re: a couple of questions," with handwritten notes. Ms. Blaskey asked Ms. Ruess if it is her handwriting. Ms. Ruess responded that it is her handwriting, except for the notation "Craig Adams." Ms. Blaskey asked Ms. Ruess if she recalled receiving Exhibit 2. Ms. Ruess said that she did not particularly recall receiving it, and noted that people always asked questions about the COSS rate structure and that it was a "hot topic." She said that although the actual structure does not change, the rates can, which caused the high level of interest. Ms. Blaskey asked Ms. Ruess to explain how rates could change but not the structure. She responded that the parameters themselves would not change but the cost of each parameter could change, resulting in overall rate increases.

Ms. Ruess was shown Exhibit 3, an October 20, 1999 email from Christine Ruess to "mev" and "dkk" re: "Sewer Cost of Service Study." Ms. Blaskey asked who "mev" and "dkk" were. Ms. Ruess responded that "mev" is Mary Vattimo (City Treasurer) and "dkk" is Dennis Kahlie. Ms. Blaskey asked Ms. Ruess if she recalled speaking with Christine Kehoe (City Council member) or Myrna Zambrano (Councilmember Kehoe's Chief of Staff) regarding the sewer COSS. She responded that she did not recall speaking with either of them. Ms. Blaskey noted that the email stated that Zambrano wanted to know "what the party line was for," and asked her what she meant when she wrote "party line." Ms. Ruess responded that she might have been quoting Zambrano and the term reflected that whatever information she communicated would have been given to her by Pat Frazier (Deputy City Manager). Ms. Blaskey asked Ms. Ruess why the COSS was delayed two years. She did not recall.

Ms. Blaskey asked Ms. Ruess what happens to a COSS when it is finalized. She responded that she would expect that once a COSS is completed and recommendations are made, it would go to the Council to implement the rates or to explain to the Council why the rates should not be implemented. She could "not imagine" not agreeing with a consultant and his final recommendations. She explained that while the consultant and the department do not issue a joint conclusion, they work closely together on a COSS and the department understands how the

consultant reached its conclusions. Therefore, typically, the department would agree with the consultant's final recommendations.

Ms. Blaskey asked Ms. Ruess whether a COSS in draft form would be shared with the public, and she responded that it would not. If the study was finalized, however, it would be a public document. She recalled one COSS that stayed in draft form. Ms. Ruess said that Councilwoman Frye wanted the COSS released and felt it should have been provided to her, but it was only provided in draft form upon her repeated requests.

Ms. Ruess was shown Exhibit 4, an October 20, 1999 email from Christine Ruess to "dkk" (Dennis Kahlie) re: "COSS Studies." Ms. Blaskey asked Ms. Ruess if she recalled writing it. She did not "particularly" recall writing it. She identified a reference to "Larry" as probably being Larry Gardner from the Water Department though she said she did not recall meeting with Mr. Gardner about the sewer COSS. Ms. Blaskey asked Ms. Ruess why she was involved with the sewer COSS. She responded that she might have been involved because Mr. Moffitt left the City's employment or because either Mr. Adachi or Mr. Moffitt were out of the office. Ms. Blaskey asked who "Pat" referred to, and Ms. Ruess said that "Pat" was Pat Frazier, a Deputy City Manager to whom Mary Vattimo reported. She said that Ms. Frazier had a say in whether the COSS went to the Council, and noted that deputy city managers made the decision regarding what to bring to the Council.

Ms. Blaskey asked Ms. Ruess to explain the quote regarding why the COSS's were not distributed earlier and which state that "[Frazier's] answer was that the reports did not justify changing the rate structure and since we did not have a recommendation to change anything we were using them simply to justify our existing structure." She responded that she likely would have obtained this information from Ms. Frazier and would have quoted her as best she could. Ms. Blaskey asked Ms. Ruess whether the quote was a true statement. Ms. Ruess responded that she could not say whether she looked at the COSS at the time, but in any COSS there would be changes recommended and the question would be whether the changes were material. She noted that you could add a component to the rate structure and that might not make a material change to the customers. However, she said in this case, adding COD was likely a material change but she may not have had the same input or belief during the COSS performed by PinnacleOne. She would need to compare the rates in the 1998 COSS with the rates at the time to tell whether the statement was incorrect or misleading. Ms. Blaskey asked Ms. Ruess how Ms. Frazier concluded that the rate structure did not need to be changed. Ms. Ruess stated that she did not know how Frazier came to the conclusion that no changes were recommended based on the COSS.

Ms. Ruess was shown Exhibit 5, an October 21, 1999 San Diego Union-Tribune article entitled, "Kehoe Denounces S.D. Sewer Rates." Ms. Ruess vaguely recalled Ms. Kehoe making her sewer rate concerns a public issue. Ms. Ruess was shown Exhibit 6, a November 1, 1999 email from Dave Schlesinger (Director, MWWD) to George Loveland (Deputy City Manager) copying Bill Hanley (Deputy Director, MWWD), Dennis Kahlie, Kelly Salt (Chief Deputy City Attorney of the Public Works Section), and others, re: "Grand Jury Review of Sewer Rates." Ms. Ruess said that she did not recall the email, and noted that she was working on water bonds in 1998-1999.

Ms. Ruess was shown Exhibit 7, a February 8, 2000 email from Christine Ruess to Eric Adachi re: "RFP," attaching a Request for Proposals for the Sewer Cost of Service & Rate Design Services. Ms. Blaskey asked Ms. Ruess to describe her involvement with the Request for Proposal ("RFP"). She responded that she might have prepared the RFP or might have just reviewed it. Ms. Blaskey asked Ms. Ruess why the City was doing another COSS in 2000, but Ms. Ruess could not point to one particular reason. She said Councilmember Kehoe was interested in having one generated. The old COSS was "too stale" because it had not been quickly implemented; the City wanted another firm to do a COSS because they were unhappy with the COSS done by PinnacleOne; and that the City was generally comfortable with Black & Veatch and wanted them to perform a COSS. She noted that for these reasons, the COSS was not done solely because of Ms. Kehoe.

Ms. Blaskey asked Ms. Ruess about Dennis Kahlie's involvement with the COSS. She responded that it had always been a frustration of Mr. Kahlie, even prior to 1996, that people were not making decisions to implement the new rate structure and the COSS. Ms. Blaskey asked Ms. Ruess why the COSS was not implemented sooner. She said that the COSS findings were not popular because of their impact on individual users so they were not implemented. She noted that it was "very clear" that industry was very vocal and opposed to the Black & Veatch COSS. Ms. Blaskey asked Ms. Ruess who had decided not to bring the City into compliance in accordance with the Black & Veatch COSS. Ms. Ruess could not say.

Ms. Ruess was shown Exhibit 8, a May 3, 2000 email from Eric Adachi to Barbara Sharatz (Pretreatment Program Manager, MWW), Bill Hanley, Christine Ruess and others re: "Cost of Service Study Kick-off Meeting." Ms. Blaskey asked Ms. Ruess to describe her involvement with the Stakeholders' Group. She responded that she cannot recall if there was a separate Stakeholders' Group for water and wastewater but recalled going to the Stakeholders' Group meetings.

Ms. Ruess was shown Exhibit 9, a March 6, 2003 email from Dennis Kahlie to Christine Ruess, Kelly Salt, and Eric Adachi re: "COSS Update," attaching a March 6, 2003 email and attachment regarding questions and answers about the COSS. Ms. Blaskey asked Ms. Ruess if Exhibit 9 helped her recall how the Black & Veatch COSS proceeded. She said it did not help her but that perhaps only a wastewater COSS was done in 2000. Ms. Blaskey asked why the COSS was dated May 2002 if the COSS began in 2000. Ms. Ruess did not know.

Rate Increases

Ms. Ruess was shown Exhibit 10, an October 24, 2001 email from Dennis Kahlie to Mary Vattimo and Pat Frazier re: "Water Rate Case." Ms. Blaskey asked Ms. Ruess to discuss the timing of rate increases. She responded that the elected officials "always want to put them off." She said it was not out of the realm of possibility that the COSS was delayed because the elected officials did not want the rates to increase. She said if there is no political will to change the rates, "why continue down that path?" Ms. Ruess stated that based on the language "the mayor wants to put off the rate increase discussion," in Exhibit 10, it appears to be the Mayor's decision to delay the rate increases. Ms. Blaskey asked Ms. Ruess if she recalled the City Manager being concerned about increasing rates. Ms. Ruess did not recall.

Ms. Ruess was shown Exhibit 11, an October 30, 2001 email from Marci Steier re: "Rate Case Scenarios – Initial Results." Ms. Blaskey asked Ms. Ruess to describe the tone of the Council regarding water rate increases. Ms. Ruess said there were a series of water rate increases that were implemented in May 2002. She recalled having to go back and forth between the Council and the Mayor about the increases, and also recalled that industry wanted a higher base fee and a lower commodities charge. She recalled that there were "lots of battles" and that industry received concessions, one of which was that 50% of the increase would be on the base charge and 50% would be on the commodities charge. Kelco and ISP (two large companies in San Diego that were the highest industrial dischargers to the City's wastewater system) were the most vocal and tried to get the restaurant association involved.

January 29, 2002 City Council Closed Session

Ms. Blaskey asked Ms. Ruess if she recalled a January 2002 City Council Closed Session. She did not recall it. She said she received a subpoena for Closed Session materials and had to go through Mr. Kahlie's files and is sure that any material about the January 2002 Closed Session had been turned over in response to prior subpoenas. Ms. Blaskey asked Ms. Ruess whether she had any conversations with Kahlie about the Council being aware of the noncompliance. She responded that she might have had such a conversation but could not specifically recall it.

City Attorney Memo regarding Noncompliance

Ms. Ruess was shown Exhibit 12, a July 23, 2002 email from Marsi Steier to Christine Ruess and Dennis Kahlie re: "Water Cost of Service." She said that Marsi Steier is the Deputy Director of the Water Department. The email mentioned requesting information from Black & Veatch regarding utility rate practices and Ms. Blaskey asked Ms. Ruess if she recalled that whether that was done or if the City Attorney's Office prepared a memo about noncompliance. Ms. Ruess had no specific recollection.

November 19, 2002 City Council Closed Session

Ms. Ruess was shown Exhibit 13, a November 18, 2002 memo from Leslie Girard to Donna Frye re: "Item No. 7, Closed Session Agenda for November 19, 2002," which was in her files. Ms. Ruess did not recall seeing it before but said she may have known of the issue referenced in it. She thought Mr. Kahlie may have given her a copy of it and also noted that she has inherited the files of other employees. She said she has never attended a Closed Session.

2002 COSS

Ms. Blaskey showed her a COSS with a November 2002 date on it and asked Ms. Ruess whether the November 2002 COSS was a draft or final version. Ms. Ruess responded that she was "quite certain" it was not finished because the water COSS was not finished yet. She said that the water updates began nearly simultaneously with the wastewater updates. Ms. Blaskey asked Ms. Ruess when the 2002 COSS was completed. She could not recall if the 2002 COSS was finished in May 2002. She said the water COSS was completed in 2003.

Ms. Ruess was shown Exhibit 14, a November 22, 2002 memo from Lamont Ewell to the Honorable Mayor and City Council re: "Transmittal of Draft Sewer Cost of Service Study," attaching a COSS hand stamped "Draft." Ms. Blaskey asked Ms. Ruess whether she knew why it was hand stamped "Draft." Ms. Ruess responded that she did not know why. She said it might be possible that she was involved in the stamping, but did not have any recollection of it. She noted it is stamped "Draft" so that it is clear it is a draft. She said she was never under the opinion that the City had a final COSS in May 2002 or November 2002, and received that understanding from either Mr. Kahlie or Mr. Adachi.

Public Utilities Advisory Commission

Ms. Ruess was shown Exhibit 15, a January 16, 2003 email from Marsi Steier (Deputy Director, Water Department) to Richard Mendes (Deputy City Manager) re: "cost of service study," attaching a January 15, 2003 email from Dennis Kahlie to Christine Ruess, Charles Yackly (Acting Director, Water Department), Marsi Steier and Sam Gray re: "cost of service study." Ms. Blaskey asked Ms. Ruess about her involvement with the Public Utilities Advisory Commission ("PUAC"). Ms. Ruess said that she recalled the rate issue going to the PUAC and remembered attending the PUAC meetings, but she personally had no involvement with the PUAC and sewer rates. She recalled industrial users were becoming more vocal and that David McKinley and Doug Sain (lobbyist for Kelco) from Kelco attended the PUAC meetings. They wanted the rates based on BOD instead of COD and she recalls their strategy was to throw ideas out to the PUAC to delay the process because even if they could delay it just a few months, they would save thousands of dollars. Ms. Blaskey asked why the PUAC addressed the COSS issue. Ms. Ruess responded that since it was a new COSS, the PUAC dealt with it. The PUAC handled rate increases in general. Ms. Blaskey asked who decided what issues the PUAC examined. Ms. Ruess responded that maybe the Chair of the PUAC, who set up the subcommittees, would decide. Ms. Blaskey asked Ms. Ruess to describe how the PUAC members were chosen. Ms. Ruess said that the members were chosen by the Mayor, and that the subcommittee members are not necessarily on the PUAC itself. She noted that for the upcoming wastewater rates, Mr. Doug Sain was chosen for the subcommittee.

Reaction to 2004 Blair Letter

Ms. Blaskey asked about the City's receipt of the February 2004 letter from Ron Blair demanding the City get into compliance with State requirements. She said that City Manager Michael Uberugua was aware of the issue and that it "seemed to be a big deal" and "was taken very seriously." Kelco applied pressure to delay the COSS implementation and wrote letters to the State directly. She thought that Mr. Sain might have gone to the State with someone from the Mayor's Office to argue for a delay. When the Council heard the issue, Kelco packed the chamber and showed a PowerPoint presentation. She said that with the February 2004 letter, the Council "could point the finger" and say that they did not want to do this but had to do it. She noted that without the letter, the Council would not have taken action based on previous rate increase votes she had witnessed. Ms. Blaskey asked Ms. Ruess if, in her view, the "threat" from the State was beneficial. She responded that the threat "helps" because "the Council does not want to be seen as the bad guy." She said that after the fact, she learned that Mr. Kahlie had asked for a strongly worded letter from Mr. Blair.

January 29, 2002 Revisited

Ms. Ruess was shown Exhibit 16, an April 15, 2004 email from Les Girard (Assistant City Attorney) to Dennis Kahlie, copying Pat Frazier and Mary Vattimo re: "1/29/02 Closed Session Matter." Ms. Ruess recalled receiving it but could not recall if she knew about the issue in 2002. Ms. Ruess said she may have had conversations with Mr. Kahlie about Councilman Madaffer's response, when he apparently told Mr. Kahlie that the Council would not take action on the sewer rates until the State sued the City.

Chronology

Ms. Ruess was shown Exhibit 17, an April 16, 2004 document entitled, "Chronology of Events: Wastewater Rate Structure Compliance Efforts As Of April 9, 2004." Ms. Blaskey asked Ms. Ruess why this chronology was compiled. She could not recall. She said the handwriting on the document is hers and Mr. Kahlie's.

Disclosure

Ms. Ruess was shown Exhibit 18, an April 27, 2004 list of handwritten notes. She said she did a memo for Vattimo based on these notes. Ms. Blaskey asked Ms. Ruess to discuss the substance of the notes. She recalled that the issues raised regarded how forthcoming Financing Services was with Paul Webber (the City's outside disclosure counsel at Orrick, Herrington, and Sutcliff, LLP). Ms. Blaskey asked Ms. Ruess if she met with Ms. Vattimo in order to draft a formal response to Webber. She said she did not recall meeting with Ms. Vattimo to draft a formal response. She said that this meeting with Ms. Vattimo occurred so that Ms. Vattimo could touch on these issues in order to communicate them to Mr. Girard. Ms. Ruess stated that no one in the City felt anything had been withheld. Ms. Ruess was shown Exhibit 19, a May 4, 2004 memo from Mary Vattimo to Les Girard re: "Disclosure Practices." She said this is the "formal" response for Les Girard to respond to Mr. Webber's allegations. She recalled writing it for Vattimo but could not be sure the document she was looking at was her draft.

Paul Webber and Noncompliance

Ms. Blaskey asked Ms. Ruess to describe her impressions of Paul Webber. She responded that Mr. Webber was the only counsel she worked with, and she found him diligent. From Mr. Webber's perspective, she said he could not look at every piece of information and verify its accuracy and that he needed to look at the reasonableness of the information he was given and ask questions, which he did. She said Mr. Webber would identify issues at the last minute and then "solve them," and she came to expect this from him.

Ms. Blaskey asked Ms. Ruess whether she recalled discussions with Mr. Webber about the City's noncompliance with state requirements. She did not. She assumed Mr. Kahlie had such conversations with Mr. Webber as part of the preparation of the Official Statement. She said that she believed Mr. Kahlie was clear that Mr. Webber did know of this issue and she said Mr. Kahlie said that the way Mr. Webber crafted the language in the Official Statement showed Mr. Webber knew. She said that Mr. Webber should have been familiar with the issue because "that's what he does." Ms. Blaskey asked Ms. Ruess if she recalled a conversation with

Mr. Kahlie in which he said he told Webber. She did not but said Mr. Kahlie told her that Mr. Webber knew and she believes that meant Mr. Kahlie told Mr. Webber. She said that from what Mr. Kahlie told her and her work with Orrick, she believes the relevant section of the POS was written by Orrick and probably reviewed by Mr. Webber.

Involvement with POS

Ms. Blaskey asked Ms. Ruess to describe her involvement with the sewer POS. She said she participated in the "all-hands meeting" for the sewer POS to provide additional assistance. She recalled attending the 1999 POS because she was pregnant at the time. She did not recall discussions about the City's noncompliance during the "page-turners."

Involvement with Rating Agencies

Ms. Blaskey asked Ms. Ruess to describe her involvement with rating agency presentations. She said she was involved in the sewer rating agency presentation but did not present anything herself. Ms. Ruess explained that sometimes joint water and wastewater presentations occurred for the rating agencies. If she was present, she would make sure things ran smoothly. She said that the financial advisor, Montague & DeRose, put the presentations together and compiled the binders. Ms. Ruess explained that the draft presentation was sent around to Financing Services, the Auditor's Office and others for comment and a "back and forth" process ensued.

Ms. Blaskey asked Ms. Ruess if the financial advisor was told of the noncompliance. She did not know, and did not discuss with Mr. Kahlie whether the financial advisor was told. She had a conversation with Mr. Kahlie about who knew of the noncompliance but could not recall specifically knew. While Ms. Ruess did not indicate when this conversation took place, it appeared to have taken place after the 2004 Voluntary Disclosure.

Pension

Ms. Ruess was shown Exhibit 19, a March 27, 2002 email from Phil Phillips (Accounting Division Manager) to Christine Ruess copying Jon Dunchack re: "funding sources – part 2." She did not recall the email. She said, from reading it, it has to do with Fire and Life Safety financing in 2002. Ms. Ruess noted that there was a "funding controversy" because Fire and Life had a different funding source (it involved financing in 2002 – the issue was, if it no longer involved financing, where it would be funded from now). She said it had nothing to do with pension issues at all. Ms. Ruess only worked with Mr. Phillips on this one project. She noted that she and Mr. Phillips "did not understand each other particularly well."

May 15, 2006 Follow-up Conversation

Proposition 218

Ms. Ruess stated that with the benefit of hindsight, she had given more thought to Proposition 218 and its relation to the COSS. She said that she had earlier said that Prop 218 did not factor into the reason for conducting the 1998 COSS but, having given it more thought, she believes now it did. She said she was putting together binders over the past few days and found the Prop 218 text that discusses the standards that had to be met. She said she does not specifically recall that Prop 218 played a role in the COSS, but thinks it would have. Ms. Blaskey asked Ms. Ruess how the COSS would have dealt with Prop 218. Ms. Ruess responded that she did not know. She said that Prop 218 did not specify how to make the rates compliant. Ms. Blaskey asked Ms. Ruess if Prop 218 required an allocation to COD. She responded that it did not.

Requests for Proposals

Ms. Blaskey asked Ms. Ruess whether PinnacleOne was hired through an RFP process. Ms. Ruess said that it was not. Rather, it was pulled off an "as needed list," a list developed so that when an issue came up, the City can limit its focus to hiring the firms on the list.

June 20, 2006 Follow-up Conversation

Validation Period

Ms. Ruess was read Exhibit 20, a January 8, 2002 email from Kelly Salt (Chief Deputy City Attorney of the Public Works Section) to Christine Ruess re: "Validation Period." Mr. Shapiro asked Ms. Ruess if she recalled the bottom string of the email in which Ms. Ruess posed questions to Ms. Salt about the validation period of bonds. Ms. Ruess replied that she recalled being involved with the issuance of water bonds in October 2002 and Fire & Life Safety Bonds in June 2002 but believed the questions she posed to Ms. Salt in the email were the result of having a general discussion with Dennis Kahlie (Utilities Finance Administrator) and Eric Adachi (Rate Analyst, Supervising Economist, MWWD). Mr. Shapiro asked Ms. Ruess if she recalled why such a conversation was taking place. She replied that she believed that in January 2002 they were starting to put together timelines as to when the City would receive proceeds from the water bonds and someone may have pointed out that the validation period was 60 days and wanted to know what would happen if certain scenarios took place regarding the validation period. Ms. Ruess noted that while the validation period is 60 days, the referendum period is 30 days. Mr. Shapiro asked Ms. Ruess if she could recall in any greater detail the conversations that took place regarding the validation period. She said she believes that Mr. Kahlie, Mr. Adachi and she had a collective general discussion to get an understanding of the validation period, what it entailed, and what would happen if someone questioned the validity of the bonds. She said Mr. Adachi and Mr. Kahlie were asking the questions she relayed to Ms. Salt out of curiosity and not in response to a particular issue. Mr. Shapiro asked Ms. Ruess if she had any concerns regarding someone challenging the validity of the bonds. Ms. Ruess said she did not. Mr. Shapiro asked Ms. Ruess if she recalled any of the questions posed by Mr. Adachi and Mr.

Kahlie. Ms. Ruess said the only questions she recalled were the ones she posed to Ms. Salt in the email.

Reimbursement Resolution

Ms. Ruess was read Exhibit 21, a January 8, 2002 email from Christine Ruess to Dennis Kahlie, Kelly Salt, and Eric Adachi re: "Fwd: Validation Period." Mr. Shapiro asked Ms. Ruess if she recalled the reimbursement resolution issue described in the email. She did not. Mr. Shapiro asked Ms. Ruess to explain a reimbursement resolution. She replied that to meet Treasury requirements, the Council must formally declare its intent to reimburse prior expenditures with subsequent borrowing and state the approximate magnitude of the debt obligations to be incurred. Regarding this particular email, Ms. Ruess said that she may have been circulating a reimbursement resolution and was just waiting for Ms. Salt's signature. Ms. Ruess also said that it may have involved an instance where the Water Department was asking Ms. Salt to use different documentation for reimbursement than what is normally required.

Conclusion

Mr. Shapiro told Ms. Ruess to contact us if she recalled any new information in the future.

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